I. Introduction

The Retail Market Participants appreciate the opportunity to reply to the initial comments filed in the Department of Telecommunications and Energy Investigation into the Pricing and Procurement of Default Service, D.T.E. 99-60. In reviewing parties' initial comments, the Retail Market Participants found significant agreement among a majority of the commenters on key issues. Foremost among these was the common desire to resolve key issues related to default service over the next few months. We recommend that the Department move forward with this proceeding to build on the common ground presented in parties' initial comments.

The following reply comments focus on discrete issues that warrant further development and discussion. The issues addressed herein are: the competitive solicitation process; default service price components; terms and conditions of default service; generation supply services and related costs; standard offer and default service pricing; and timing of implementation.

II. Competitive Solicitation Process

While there is clear agreement that the statute requires distribution companies to procure default service through competitive bidding, many details of the bid process remain to be decided. Two initial questions require further consideration. First, should the competitive solicitation be conducted on a statewide basis, or separately for each utility service territory? And second, should the bid be for all customers (either within the commonwealth or within each service territory) or divided into subsets of customers?

The Retail Market Participants advocate customer class bids by distribution company for two reasons. First, a class bid by distribution system is a simple way to allow multiple suppliers to provide default service thereby reducing market power issues. Second, a class bid by distribution system will result in default service prices that are more likely to reflect the "average monthly market price" of competitive service for customers within that class.

Some commenters support a single default supplier per service territory while others support a statewide default service provider. There are serious market power implications to consider when a single provider is able to gain the scale that a statewide bid would create. This would immediately put this provider at a considerable advantage over others who may have lost the bid by very narrow margins. Each subsequent bid would be more difficult for other providers to beat as this single provider will be the only provider who has experience with the service and understands its costs. A single state provider model could end up being a statewide monopoly. This concern would be somewhat dampened

by conducting separate solicitations for each utility service territory. In the long term, however, customers will receive the greatest benefits from a market structure with multiple default service providers in each territory.

This leads to the second question: whether the solicitation should be for all default customers within a utility service territory, or for some subset of those customers. The Retail Market Participants advocate structuring the bid process so that there are multiple winners within each service territory. This is an important mechanism for ensuring that undue market power is not placed in the hands of a single winner. Further, separating default service customers by customer class (*i.e.*, residential, commercial and industrial) improves the accuracy of default service price signals.

Accommodating the risk associated with customer migration to and from default service is an important element in the price of that service. Because each customer class has its own attendant risks, the true cost of serving each class will vary. For example, one might expect industrial customers to only take default service for brief periods of time when they are between suppliers. These customers would carry a considerable amount of volume risk that probably would not exist in the residential class. Residential customers may exhibit more predictability and may stay on default service much longer, providing less volume risk for the default supplier, thereby allowing the supplier to bid a lower price than that bid for industrial load. Class-specific pricing also would provide the ability to differentiate the terms of default service among classes. (For example, by changing the pricing for industrial customers more frequently than for commercial or residential customers in order to eliminate gaming).

Different prices for different classes will send the correct market price signals. If cost differences caused by varying load shapes and varying customer characteristics are not taken into account and only average costs are considered, some customers will benefit by moving off default service, others will benefit more by remaining as default customers. The competitive market will price each class differently. If default service is to reflect the market, it should price each class differently as well.

An additional benefit of allowing class-specific default service bids is that each service territory will be served by multiple providers while avoiding the potential complexity of having to divide customers randomly. The Department will be able to avoid questions regarding how to ensure that each supplier takes on the same risk, deciding which supplier's name to put on a given customer's bill, and determining the ultimate price created from the winning bids.

III. Elements to be Included in the Price of Default Service

A. Area of Consensus – Include at Least the Full Costs of Providing Default Service

There was broad consensus among the commenters that the price of default service should include **at least** all of the costs that the utility incurs in providing default service. These costs include both commodity-related costs and administrative costs.

The commodity-related costs include:

- wholesale commodity costs, including energy (and associated transmission losses), operating reserves, AGC, Operable Capability, Installed Capability, ISO uplift and administrative charges associated with spot market purchases of these commodities;
- transmission charges (service charges, congestion charges, and ancillary service charges not included in commodity costs above);
- scheduling, balancing and control area services;
- distribution system losses;
- share of ISO-NE and NEPOOL operating expenses;
- risk management premiums;
- load shape costs;
- commodity acquisition and portfolio management;
- working capital; and
- taxes.

The administrative costs include:

- general overhead;
- contract procurement by the distribution company;
- credit, collections, and bad debt;
- customer enrollment;
- customer service;
- data exchange; and
- metering and billing

There is also general consensus on the following points.

The bid price of default service suppliers should include as many of the costs described above as possible.

Should any of those costs not be included in the supplier's bid price (e.g., utility overheads), then an adder should be calculated and added to the bid price to create the default service price to customers.

Third, since the costs to be included in this adder are already included in distribution rates, a credit mechanism should be created whereby the revenues collected through the adder are flowed back to customers through a credit on the distribution portion of the bill.

A. Area of Disagreement—Whether to Create a True, Competitive Market Price

The Retail Market Participants agree with the other commenters on the points discussed above. We urge the Department, however, not to stop there. To do so would fall short of taking the steps necessary to create a competitive retail electric market.

The section above creates a regulated utility cost of service model for default service pricing. Conceptually, it is no different from the Integrated Resource Management ("IRM") scheme that Massachusetts rejected in favor of retail competition. As under IRM, generators will bid to utilities to provide supply, and utilities will remain the retail providers of electricity. If this is where we wanted to end up, we need never have embarked on the long journey of electric restructuring.

This "IRM 2" scheme will not create a default service price that reflects a market price because it looks only at the costs that a utility incurs to provide default service; it does not consider the costs that a competitive firm will incur to provide a competitive service. A competitive firm incurs additional costs, including customer acquisition costs, that a utility does not incur because it acquires customers "by default." Unless these costs are included, default service will play the same role that the Standard Offer has played: a below-market utility offering that prevents a competitive retail market from developing.

Some have suggested that this would not be a bad result. They say that if the utility is the lowest cost provider, it should get all of the customers. Retail suppliers should win retail customers only if they can beat the utility's cost of providing the service.

We offer two responses. First, as we discussed in our initial comments, there are tremendous customer benefits that will only be realized through retail competition. Retail competition will not develop, and hence those benefits will not develop, if default service is priced below the competitive market price.

Second, as competitive firms, we would be delighted to compete against the utilities and their cost of service -- as long as we all started in the same place. That is not, however, the condition that we face. We do not have an open competition for new customers. Instead, we are competing against deeply entrenched incumbents. The utilities ***inherit*** customers; we have to ***earn*** them. And earning customers takes more effort and more money. Setting the default service price at the utilities' ***cost to inherit*** is no way to create a competitive retail market.

IV. Terms and Conditions of Default Service

Although most of the commenters have correctly focused on the price of default service, there is another important issue: terms and conditions. When comparing competitive offerings to default service, customers will examine terms and conditions as well as price. In order to promote a vibrant competitive market, it is essential that the default service terms and conditions be as basic as possible, and not include any of the value-added guarantees and services that competitors will offer. These value-added terms and conditions include price stability, green power, on-line billing, and others.

V. Generation Supply Services and Related Costs

One commenter has stated that the distribution companies should "retain the role of the load serving entity with ISO New England," and "This initial approach could involve distribution companies in generation supply services as well." This approach would have several entities bearing the costs of being the load serving entity and would obviate the stated goals of full functional separation between suppliers and distribution utilities. Moreover, it would preclude default service providers from optimizing their portfolios of customers and supplies, thus reducing the benefits of competitive markets for consumers.

To avoid duplication of costs and enable default service providers to optimize their generation supply portfolios, default service providers should be responsible for all generation supply services. These services include those related to being a load serving entity with ISO New England.

VI. Standard Offer and Default Service Pricing

Some commenters support keeping default service at the standard offer rate. Keeping default service at a standard offer rate, however, will postpone once again the Massachusetts electricity market from becoming a competitive one. If default service is maintained at a below market cost, customers will have little incentive to participate in the competitive market. Likewise, competitive suppliers will have little incentive to enter the market.

Not only would this be detrimental to developing a competitive retail market in Massachusetts, but also it would be inconsistent with the statute. Chapter 164, section 193(1B)(d) provides that default service must be competitively procured at a rate not to exceed "the average monthly market price of electricity." The commenters are in agreement that default service is a retail service and therefore should be a retail price as required by the language of the statute. The standard offer rate, however, is not a retail price. In fact, standard offer is not a market price; it is a below market price. That is, maintaining default service at a standard offer rate would not be procuring it at an "average monthly market price."

Providing default service at standard offer price is only possible if there will be above market prices on the back-end or cost deferrals to be recovered later. Customers today would be receiving an artificial discount or subsidy by unfairly imposing costs on customers of the future. If default service remains at the standard offer rate, utilities will be allowed in the future to recover the losses they would likely incur by offering these below market rates. The future thus promises increasing rates driven by the short-term savings.

VII. Timing

Commenters have proposed a wide range of timeframes for implementing market-based default service pricing. The Retail Market Participants recognize that consideration must

be given to certain logistical issues, such as Year 2000 computer concerns. Nevertheless, each month of delay perpetuates a structure that is not compatible with the development of a competitive market. We urge the Department to establish a structure that will produce market-based default service prices, as described in Section III, above, no later than the second quarter of 2000.

VIII. Conclusion

The Retail Market Participants are encouraged by the substantial agreement expressed in the initial comments of parties to this proceeding. We are hopeful that continued discussion among the parties can produce even greater agreement on a workable solution to the many facets of default service procurement and pricing. We look forward to participating in any further discussions of this important issue.

Respectfully submitted,

Rebecca Bachelder AllEnergy Marketing Company 95 Sawyer Road Waltham, MA 02453 Phone: (781) 906-2264 Fax: (781) 906-2002 e-mail: rbachelder@allenergy.com	Carrie Cullen Hitt GreenMountain.com 36 Sparks St., Suite 1 Cambridge, MA 02138 Phone: (617) 492-7157 Fax: (617) 492-0755 e-mail: hitt@greenmountain.com
Robert C. Rossignol Director, Market Pricing Analysis Alternate Power Source, Inc. 400 Blue hill Drive, Suite 188	Stephen J. Remen Managing Director National Energy Choice 530 Atlantic Ave.

Westwood, MA 02090 Phone (781) 320-9737 Fax (781) 320-8904 Email rrossignol@alternatepower.com	Boston, MA 02210 Ph. 617-772-7530 Fax: 617-772-7550 email: sremen@nechoice.com
Antonio D. Aguiar EnergyEXPRESS, Inc. 2000 West Park Drive, Suite 300 Westborough, MA 01581 phone (508) 599-7122 fax (508) 871-0988 email taguiar@energyusa.com	Kathryn E. Loebs NEV East, LLC 535 Boylston Street, Top Floor Boston, MA 02116 phone (617) 859-3666 fax (617) 859-3008 email kloebs@newenergy.com
Sue Nord Enron Energy Services 2 Capital Plaza Concord, NH 03301 Phone: (603) 224-5942 Fax: (603) 224-7601 e-mail: snord@enron.com	Stephen Cowell Sun Power Electric Div. of Conservation Services Group (CSG) 40 Washington Street Westborough, MA 01581 Phone: 508-836-9500 Fax: 508-836-3138 Email: Steve.Cowell@csgrp.com

Patricia Blasioli	Chris King

Exelon Energy 28 State Street, Suite 1100 Boston, MA 02109 Phone: (617) 573-5074 Fax: (617) 573-5075 Pblasioli@exeloncorp.com	Chief Executive Officer Utility.com 828 San Pablo Avenue Albany, CA 94706 Tel: 510-558-9107 Fax: 510-558-9308 e-mail: Chris.King@utility.com
Paul Gromer Executive Director Northeast Energy Efficiency Council 77 North Washington St. Boston, MA 02114 Tel: 617-367-6144 Fax: 617-367-6299 e-mail: pgromer@peregrinegroup.com	